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Simmons, Wallace Delafield

An address by Wallace D. Simmons

[Philadelphia]

[1919]

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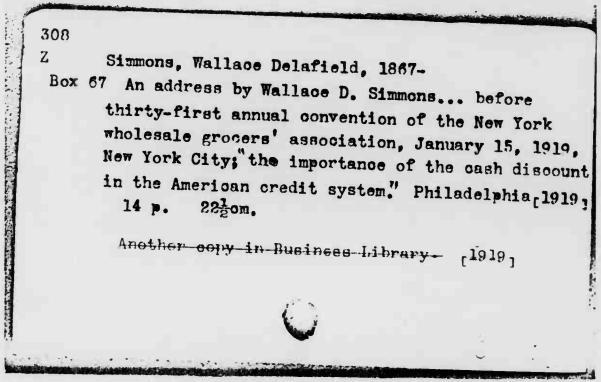

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Box 67 An address by Wallace D. Simmons... before thirty-first annual convention of the New York wholesale grocers' association, January 15, 1919, New York City; "the importance of the cash discount in the American credit system." Philadelphia [1919]
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308
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Box 67

An Address

By

WALLACE D. SIMMONS

President of the Simmons Hardware Company, St. Louis, Mo.

Before

Thirty-First Annual Convention of the
New York Wholesale Grocers' Association, January 15, 1919
NEW YORK CITY

"The Importance of the Cash Discount in the American Credit System"

Sent out with the Compliments of George H. Paine, Philadelphia, Pa.

1 March 1920 - C.R.W.

MR. PRESIDENT AND MEMBERS OF THE NEW YORK WHOLESALE GROCERS' ASSOCIATION

GENTLEMEN:

I was glad to respond to the invitation of your President to speak to you here today because it would give me an opportunity to meet again many of you whom it has been my privilege to know and also to express the very high regard in which I hold your President, Mr. Sylvan L. Stix.

In response to my question as to what he would like to have me talk to you about, Mr. Stix suggested that I discuss the "cash discount." I am very glad to do so because it is high time for someone to give public expression to the many good things that can and should be said in favor of our American System of Credits, which is at present the object of frequent attack by a few men who are spending a great deal of time, energy and money in an organized effort to undermine it and to substitute for it a system built on the European idea which was discarded in this country after our Civil War because it had been tried and found wanting and because of the intolerable abuses which it had developed.

We should be particularly careful to avoid accepting at their face value certain arbitrary or dogmatic assertions which are made apparently with the idea that the business men of the United States are too busy with their own present day affairs to take the time to familiarize themselves with our recent economic history, or to check the soundness of radical statements condemning the customs which have grown up in our domestic trade; customs which are the outcome of an intelligent effort by American business men to devise ways and means of meeting American conditions.

In order to get a proper perspective as a basis for sound judgment with reference to this subject, let us refresh our memories on one or two points. First, we must not take hasty judgment or assume that because Europe has been doing a thing longer than we have that their way must be right and our way, if it differs from theirs, must be wrong.

In building our first automobiles, we properly endeavored to

use the former experience of European builders, but we did that so blindly that we put our driving wheels on the right-hand side because that is where we found them in the European machines. Then, after several years, we woke up to the fact that the conditions which led the European designers to put the driving wheel on the right-hand side did not exist in this country. It was because of their rule of the road "Keep to the left"; therefore, had we followed the spirit rather than the letter of their plan, we should have put ours on the left, because our road rule is "Keep to the right". It took us several years to get that into our heads. It will be even more stupid for us to run along for another generation and then let somebody find objections to having the driver sit on the left side and try to pursuade us to put it back on the right-hand side, using the European practice as an argument for doing so.

Then let us briefly review the conditions under which we went through the development stages of our domestic commerce and compare them with the conditions in other countries—in order that we may understand why different trade practices were not only advisable but necessary.

This country which grew commercially so much more rapidly than any other country is the only one which grew up under a Republican form of Government. All the others which grew with such comparative slowness were under Monarchies. The fundamental principle of Monarchy is that of tribute to one central point—the concentration of power and control. Commercial systems under such influences have all developed along Monarchical lines—the principle hinders the commercial growth of all places except the seat of power and control.

In a Republic the principle of Government is just the opposite and the commercial growth which it fosters accordingly tends to develop the country throughout. It produced so distinctly new and different a system of distribution as to make different customs and trade practices a most natural and necessary sequence.

When we devise ways and means of meeting certain business conditions, we must devise those which will facilitate doing business successfully under those conditions. To do that we must not overestimate the relative importance of having the methods wholly free from even theoretical objections.

The man who expects to find the daily routine of business

conform invariably to the lines of academic theory, the man who expects to have no troubles arise in the daily conduct of trade—no tendency to abuse trade customs, trade restrictions, or trade privileges—had better keep out of trade entirely.

At the foundation of every successful business will be found somebody's intelligent knowledge of human nature and his tactfulness in handling human nature as God made it.

There are those who by their criticisms of the average run of people as they are turned out by the Almighty Creator appear to think that they could have done very much better than He, and who consequently assume the role of repairers and correctors of the Almighty's mistakes. Their method is usually to lay down inflexible rules to which all must conform. In some parts of the world they call that sort of thing Kultur and if I correctly interpret the signs of the times, it is not now enjoying that degree of popularity which certain of its advocates counted on.

Those of us who hope to pay dividends out of the earnings of the coming year, must know how to deal with people as they are A. D. 1919. That is exactly what was done by our predecessors who devised the American System of terms and credits to meet conditions as they were at that time in the United States and to deal with human nature as it was then. As nearly as I can learn the fundamental changes in the average of human nature have not been great during the intervening years.

We must remember that at the close of the Civil War, there was plainly in sight the opportunity to settle and develop a very large portion of the territory of the United States, the possibilities of which had as yet hardly been scratched.

With the development of this new country came the development of new mercantile centers and that meant opportunity for the more adventurous of those who had had experience in mercantile pursuits in the older parts of the country. They were generally the younger men who wanted to go out into a new country.

Such people usually have limited capital. Those who have already accumulated comfortable fortunes are as a rule the older men and they are less disposed to pioneer.

This situation brought about a close and co-operative relationship between the large wholesale merchants in the jobbing centers and those more adventurous retailers who were growing up with a

new country. A like relationship had never before existed in any other country.

When it was found that the customs and trade practices of Europe, which had been brought over here by the early settlers, did not meet these conditions, the merchants promptly devised others which would meet them and which have met them ever since.

Of course, it is easy enough to work out a logical argument to reach the conclusion that the methods adopted at that time were theoretically unhealthy and hence undesirable, but the facts remain that our country was built up with the help of this system and its internal trade developed by handling our unique situation in an entirely original way. It never could have grown as it did—it never could have been what it is today but for the evolution of the American "open account," "cash discount" system. Many of our most prosperous business centers throughout the country are today monuments to the business acumen of the men who built up our domestic trade under our own credit system, by knowing how far to follow academic theory and where to leave it.

Those who devised this system took a similar course to that which is adopted by fire insurance companies with reference to certain classes of risks. These companies do not demand that certain types of buildings must be torn down, nor do they refuse to write insurance on them. They very properly recognize, that under certain conditions and in certain localities, variously constructed buildings of certain types are worth while. They simply make their rates in harmony with the hazards involved and they modify these rates as the hazards are reduced. In like manner the wholesale merchants who worked out the American "open account"—"single-name" paper—"cash discount" system recognized the risk involved in one type of credits as compared with another. They offered to the pioneer merchant of limited capital every assistance and facility to enable him to build up his business rapidly, to make it profitable and to get on a stronger financial footing. They gave him every inducement and encouragement through that course, to get in position to pay his bills promptly upon receiving them, and in line with that policy they offered to the man who was in a position to eliminate or minimize credit risks, proper compensation for so doing. This was a practical, sound and far-sighted adaptation

of the idea of mutual or group credit insurance. The manner of working it out was somewhat unusual but the principle was there and the effectiveness.

While the situation in this country has changed somewhat and at present materially differs in some sections—careful study will show that the difference is not so great after all.

Even in this section in which you gentlemen do business and which is perhaps as thickly populated and as thoroughly established in business customs as any other section in our country, there are still to be found many instances where young and progressive merchants of limited capital are glad to take advantage of credit periods covering sufficient time for a turn-over of their stocks. Those of you who are judiciously offering such opportunities to worthy young men of the right type and who are constantly holding before them the advantages to them, even more than to you, of getting on a discount basis are, I believe, conducting your business on lines which conserve the best interests of the country as a whole. I believe, therefore, it is wise that this American credit system and the value of it, should be maintained.

To maintain its value and particularly the value of the "cash discount" feature of it, we should keep constantly in mind the fundamental elements of that feature. They are, as I see them:

First, that the "cash discount" is distinctly a quid pro quo. It is a price paid for a distinct value received. The quid, is the amount of the discount allowed. The quo is the shortening of the period of credit risk effected by the payment of the account on or before a definite date much earlier than its net due-date.

The discount represents the value of the use of the money for a definite period, plus the value of eliminating the credit risk by final settlement of the account within a period very much shorter than that of its net due-period.

On terms 60 days, with 2% cash in 10 days, it means that the debtor has the alternative of paying the bill in full 60 days from the date of invoice, or he has the option of deducting 2%, provided he places the funds in the hands of his creditor, so as to release him from all further credit risk at least 50 days before the account is due and payable. 2% for 50 days is practically at the rate of 15% per annum.

When this custom was first established, we had very few of the

facilities which are so common today—few railroads, slow mail service, few telegraph lines, no telephones, no mercantile agencies, in fact few if any credit report facilities.

The value of the discount at that time to the creditor was divided about half and half. About one half of it represented interest and the other half represented the value of eliminating the credit risk by a final liquidation of the account.

While modern facilities have reduced rates of interest and the average credit risk, they have also increased opportunities for turning over capital in mercantile pursuits. Therefore, the value of the "cash discount" to the creditor as well as to the debtor has changed only in the matter of degree, and in the final analysis it will be found that the degree is less than one would think except after careful study of all elements of the question.

There have, of course, been many abuses of the "cash discount" but they do not seem to me to have been weaknesses in the plan so much as evidences of weakness on the part of individuals who have not had the courage to do what can be done to maintain the value of the plan by insisting upon getting the quid for the quo. Bradstreet reports that 86% of the last year's wrecks were due to the incompetency of those who failed, and not to any defect in the credit system.

After a good many years of careful study of instances where people want the "cash discount" when they are not entitled to it, I have reached the conclusion with which I feel confident you will agree, that most of the troubles of this kind are because of a lack of intelligent understanding of the essence of the matter on the part of the debtor. Perhaps that lack of understanding on the part of many of the small merchants is your fault and mine, because of our failure to have done what we could have done to create a general understanding of the A. B. C's of the proposition and by doing so to forestall most of the troubles.

There is, however, abuse of the "cash discount" plan to which I wish to refer. At least it seems to me to be an abuse of the principle involved and by those who can ill afford to abuse it—I mean those who offer the discount to others.

I refer to the custom of making the terms of credit so short and the so-called "cash discount" so large, as practically to make the terms net cash. It is either abuse or the evidence of conditions

existing in that line of business which create extreme credit risks.

For instance, in some lines of merchandising the usual terms now are 30 days with 5% for cash in 10 days. That practically means that no man who cannot discount can afford to stay in business. His competitors with more capital, will buy goods under those circumstances so much lower as to make it only a question of time when they will force him out entirely.

A differential of that kind is not a "cash discount" as I see it. It is simply going through the motion of offering a "cash discount" but in reality selling goods on terms—10 days net.

I have no quarrel with the man who makes his terms 10 days net—and, hence, offers the goods only to those who have or can get ready cash to pay for them. I do quarrel with any plan which makes it very difficult, if not impossible, for any small merchant to do business in this country unless he has sufficient capital to buy all his goods for cash. I am a great believer in giving the able, thrifty, industrious young man of small means a chance to branch out for himself. I believe the American credit system gives just such an opportunity with adequate protection to all interests involved. I believe that plan is in line with one of the basic ideals of our country, one of the prime assests of American citizenship—the chance to prosper and progress to whatever extent each man has in him the requisite capacity, energy and business ability to take advantage of the opportunities which abound in this great Republic.

There is another abuse of the "cash discount" which the business men of this country have lately been urged to adopt and which is so full of fallacies that it would take a large volume to cover them all in detail.

The idea is that we should allow the "cash discount" to a man who sends us a Trade Acceptance. That is simply giving the quid without getting the quo—giving the "cash discount" without getting the cash—giving the value of eliminating the credit risk, and then having it extended instead of eliminated—allowing each customer to borrow money on our credit by endorsing his paper, and then paying him for the privilege of doing so.

For instance, those of us who are doing business on terms of 60 days with 2% for cash in 10 days are urged to offer to our customers the privilege of sending us a 90 day Trade Acceptance

within 10 days and deducting the 2% "cash discount." Let us see how that would work out as compared to the present arrangement.

Roughly speaking, about half of our customers discount their bills—it is probably more than half in dollars and cents, therefore we get half of our money within 10 days. We get cash and the transaction together with the credit risk, is terminated. Of the other half, the large majority pay their bills at the end of 60 days. Some few run over a little bit, but the average of the whole, including the half which pays in 10 days results in about a 45-day credit period with an allowance of 2% on one-half of the total or 1% of the whole amount.

The plan we are urged to adopt instead of that, is to allow 2% to everybody but to charge them 1½% interest for 90 days which interest we in turn would pay to the bank. Therefore, we would be out 2% discount on the whole business instead of 1%.

Then, in order to transfer this loan to the bank we must endorse each customer's note for the full amount of his purchases and wait for an average of 90 days instead of 45 for the closing of the account and our liability and the elimination of the credit risk.

Of course each of these objections is explained away by a lot of plausible sounding generalities, such as the statement that the liability is only a contingent one. As a matter of practical fact, it is, of course, not much more so than under the "single-name" paper plan by which we take a statement to our bank as a basis for making a loan. If this statement shows accounts receivable of an amount less than we wish to borrow and an equal amount of merchandise or other quick assets, we have no trouble in borrowing the money. In fact it can be more easily done that way because back of the loan are practically the same assets, simply expressed in a different and very much more convenient form. These same assets are just as liquid in the form of good accounts on your books, and searching inquiry among the bankers of the country has shown them to be more ready to make loans to those who keep their assets in that form and their records of past collections in such shape as to give the banker an accurate estimate of the percentage of them which will be collected before their notes will be payable.

Your ability to pay this note when it comes due is chiefly contingent upon your customers paying your accounts so that the contingency in that case is practically the same as in the other. It

is simply a matter of the form in which it is expressed.

Your banker's basis for accepting your customer's notes with your endorsement will be found in the other assets which show in your financial statement.

We have heard frequently, of late, from certain quarters, expressions of surprise that the Trade Acceptance has not been more generally adopted by the business men of this country. One of the few of the larger bankers who accept the view of the Trade Acceptance Propagandists, a Vice President of a large eastern bank, has said that it was a matter for real concern that their use has made comparatively little progress, whereas the Bank Acceptance has been quite universally used by those to whose business it was adaptable.

I think the answer to that is that the gentleman under-estimates our average intelligence. The reason we promptly adopted and now make frequent use of the Bank Acceptance is that we found it a sound and useful credit instrument and had no difficulty in recognizing its good qualities.

By the same token we have not found in the Trade Acceptance the qualities for which it is recommended by its advocates and we have not been as easily persuaded to accept camouflaged sophistries as substitutes for facts, as was evidently expected. The gentleman in question should travel more and get personally acquainted with a larger number of business men throughout the country. He would find that when it comes to a matter of this kind, most of them are from my native state (*Missouri*).

It does not seem to me strange that we should not jump at the chance to take a note or a check dated ahead, instead of a check which can be promptly turned into cash. I am not surprised at all that in spite of a most vigorous campaign and propaganda throughout the country, extending for considerably over a year, there are so few Trade Acceptances being used as to make them a negligible factor in our financial conditions. That, as I see it, is because the Trade Acceptance which is offered for our use is the foreign instrument but with the heart of it left out. The shell which is left has no advantages and many disadvantages as compared to the American practice.

It is generally accepted that one of the most important points to be kept in mind in the planning of a system of credits and collec-

tions, is that a plan is undesirable in proportion as it increases the average credit period and desirable in proportion as it shortens it. I believe a careful analysis of the various plans in vogue throughout the world will leave no room for question that the American plan has resulted in a shorter average credit period than any other. This is a fact which is pretty generally dodged by those who are endeavoring by direct or indirect methods to do away with the American System and its "cash discount."

There has been an effort to make it appear that the Federal Reserve Law was distinctly planned to encourage the abandonment of the American System for the European, but there is absolutely no foundation for any such statement.

It was my privilege during the year 1913, to act as Chairman of the Banking and Currency Committee of the Chamber of Commerce of the United States, a Committee which, as you may recall, had considerable influence in the framing of the present law, so that I am quite familiar not only with the wording of the act as finally passed, but also with the discussions incident to its formation.

There was not, in the original enactment, any provision for domestic acceptances at all. That came several years afterward when the operation of the law had been proven a success beyond question, and without the use of domestic acceptances.

Later, when there arose a demand from certain quarters for the privilege of using domestic Bank Acceptances and Trade Acceptances, such a provision was incorporated in the law but with very careful safeguards and restrictions.

Effort has been made to make it appear that these safeguards or restrictions favored the Trade Acceptance plan as contrasted with the American plan, but a careful reading of the law will show that the facts were just to the contrary.

The advocates of the universal adoption of the Trade Acceptance made quite a point of the following provision, viz:

> "Any Federal Reserve Bank may discount notes, drafts, and bills of exchange arising out of actual commercial transactions."

In their comments, they endeavor to have it appear that this provision of "arising out of actual commercial transactions" applies to all of these different forms, whereas, as a matter of fact, it

applies only to bills of exchange. They are the only ones which are limited in this way, showing that Congress very wisely had in mind to safeguard against the abuses which had developed in the "Bills of exchange" system and on account of which that system was abandoned after the Civil War and the American System of "open accounts," "cash discounts," and "single-name" paper devised.

This "Cash Discount" system provided then and provides now an adequate means of governing two important factors in our domestic trade, one, that of enabling the new merchant to take advantage of opportunities, to grow by availing himself of the credit accommodations offered by those firms whose representatives visit him regularly and are personally acquainted with his business, his methods and his likelihood of success.

It also provides amply and correspondingly for the man who does not need credit accommodation but who can, so to speak, carry his own credit risk.

You know, I am sure, that it is also said by those who are endeavoring to bring about this change that the Trade Acceptance plan and the "cash discount" will work side by side in perfect harmony, but anybody who studies carefully the actual workings of the delightful plan of co-operation between the two methods which is promulgated, will see how theoretical and wholly impractical is that notion. This idea, however, is apparently an after thought—a case of trying to be all things to all men—because at first they cited the "cash discount" as one of the things that the adoption of the Trade Acceptance was going to do away with and that is exactly what it would do since the two cannot mix; they are no more harmonious than oil and water.

Then again, as you will recall, the Federal Reserve Law working in thorough harmony with the American System which provides for the payment of all accounts by check, provides for the clearing of these checks at par.

If we should allow ourselves to be led to abandon the American System by substituting acceptances for "cash discounts," it would, of course, mean the substitution of the payment by note for payment by check, and if the scheme is worked out according to the evident design, it would mean that, for every one of our invoices we would have a note which we would have to pass through our banks for

collection and on each one of which there would be a collection charge.

It is interesting to note in this connection, items which frequently appear in foreign trade reports, showing that the American method and particularly the "cash discount" feature is being adopted more and more in foreign countries, both European and Asiatic countries in which the older method has become so thoroughly established as to make the idea of a change almost unthinkable. This tendency, however, should make us all the more careful not to be influenced to give up a plan because objections to it are brought up by those who may not be wholly disinterested in the selection of their arguments. We should at least make sure that the method which we are asked to adopt has not in it still greater objections and would be less adapted to our needs.

To sum it all up in a nut shell, our American System has proven itself to be a good system, one particularly well suited to our needs, one which produces the shortest average credit period found anywhere in the world, one under which we have prospered and grown more rapidly and more solidly than any other country in the world, and we should be very foolish to allow anyone to lead us to abandon it. Before doing so, let us, at least, dig thoroughly into these whys and wherefores which are so glibly and assertively given us as reasons for such action. The more I study them, the more I am convinced of the soundness of the American "open account," "cash discount," "single-name" paper system and the farsightedness of the men who devised and developed it to meet the American conditions.

When you find a group of bankers spending a lot of time, energy, and money to persuade you to adopt a new scheme which will reduce your net profits by an amount equal to one per cent. of your total sales, and still further, to the extent of a collection charge for every invoice; and when you find all of these amounts would be paid by you to bankers it is time for you to "STOP, LOOK, and LISTEN."

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